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No. 84-323

In the Supreme Court of the United States

OCTOBER TERM, 1984

LEATHERBY INSURANCE COMPANY,
a/k/a WESTERN EMPLOYERS INSURANCE COMPANY,
Petitioner,

vs.

MERIT INSURANCE COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW*

1. Whether, in the circumstances of this litigation, where finality has been denied for almost four years to a unanimous arbitration award that was itself the product of a three-year arbitration, the court of appeals erred in holding that petitioner's appeal should be dismissed because the arguments which petitioner sought to raise were arguments that it could have raised on an earlier appeal, but petitioner chose not to raise for reasons of litigation strategy.

2. Whether the court of appeals abused its discretion when, on its own motion, it granted to Merit an award of attorneys fees and costs under Fed. R. App. P. 38.

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* Respondent Merit Insurance Company is a wholly-owned subsidiary of Merit Financial Corporation, which is privately held.

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BRIEF IN OPPOSITION

STATEMENT OF THE CASE

A. The Substantive Dispute and the Arbitration.

The history of this protracted litigation begins almost 12 years ago, in October 1972, when Leatherby Insurance Company ("Leatherby") and Merit Insurance Company ("Merit") executed a reinsurance and assumption agree-

ment (App. 2).[1] In that agreement, Merit undertook to reinsure all claims that could be made against Leatherby through its retrospective agent, General Auto Placement, Inc. (App. 20). Merit subsequently discovered that Leatherby had failed to disclose several material facts with respect to the reinsurance transaction and also had concealed "secret" cash reserves, thereby fraudulently inducing Merit to enter into the agreement (App. 20-21).

In 1976, Merit therefore brought suit against Leatherby and certain other parties in the United States District Court for the Northern District of Illinois. Leatherby, based on an arbitration clause in the reinsurance agreement, moved successfully to compel arbitration. *See Merit Ins. Co.* v. *Leatherby Ins. Co.*, 581 F.2d 137 (7th Cir. 1978). *See also Merit Ins. Co.* v. *Colao*, 603 F.2d 654 (7th Cir. 1979), *cert. denied*, 445 U.S. 929 (1980).

The parties subsequently selected as arbitrators three Chicago lawyers (including a past president of the Chicago Bar Association and a former Director of the Illinois Department of Insurance), all of whom were experienced in insurance matters (App. 19). At the outset of the arbitration, it was decided that the arbitrators would all function as "neutral" arbitrators (App. 2). The arbitration panel eventually heard live or deposition testimony from more than 25 witnesses in an arbitration that spanned

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[1] The following abbreviations will be used in referring to the record:

"Pet." and "Pet. App." for the petition and the appendix annexed to the petition, respectively;

"No. 83-653 Pet. App." for the appendix attached to Leatherby's petition for a writ of certiorari in No. 83-653, filed October 19, 1983;

"App." for the appendix annexed to this brief; and

"O.R. Item" for original record materials.

three years and 120 sessions, and which eventually produced a transcript in excess of 16,000 pages (App. 19). In December 1980, the panel unanimously awarded Merit damages in the amount of $10.675 million, which was approximately one-third of the total amount sought (*see* App. 24-25).

B. The Proceedings to Confirm the Award and Leatherby's First Rule 60(b) Motion.

In December 1980, Merit petitioned in the United States District Court for the Northern District of Illinois for confirmation of the arbitration award under 9 U.S.C. §9 (O.R. Item 1). Leatherby tenaciously opposed confirmation. Leatherby moved to vacate the arbitration award in state and federal courts in New Jersey, but those actions were dismissed for want of jurisdiction (O.R. Item 85 at 1-14). Leatherby also moved in the United States District Court for the Northern District of Illinois to vacate the award under 9 U.S.C. §10 (App. 19). Leatherby's principal grounds for seeking vacation of the award were the following (App. 25): (1) that the arbitrators had failed to follow the applicable law; (2) that the damage award improperly included punitive damages (despite the arbitrators' unequivocal statement to the contrary); (3) that the arbitrators relied upon erroneous estimates of Merit's reserves; (4) that the arbitrators failed to allow a 50% setoff on the award allegedly required by New Jersey law; and (5) that the arbitration panel was biased against Leatherby.[2]

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[2] Leatherby's bias claim was based solely on its disagreement with certain evidentiary rulings and on a single comment made by Arbitrator John Bolton during the three-year arbitration (App. 36-38). That claim, which the district court found to "have a distinctly hollow ring" (App. 38), was not related in any way to the bias claim that Leatherby subsequently raised in its second Rule 60(b) motion, which related only to Arbitrator Jack F. Clifford (*see* pages 4-5, *infra*).

The district court exhaustively reviewed the entire arbitration record, and, in a comprehensive memorandum opinion rejecting each of Leatherby's contentions, confirmed the award on November 19, 1981 (App. 19-40). Leatherby then moved under Fed. R. Civ. P. 60(b) for relief from the judgment on the grounds that the arbitrators had not sufficiently explained the reasons supporting their award and had failed to apply the 50% set-off on the award allegedly required by New Jersey law (O.R. Items 62, 65). That motion was denied on December 16, 1981 (O.R. Item 70).

C. Leatherby's Appeal in No. 81-3053.

Leatherby thereafter appealed to the Seventh Circuit from the district court's judgment confirming the award and from the court's order denying Leatherby's first motion for relief from the judgment under Rule 60(b). On that appeal, which was docketed as No. 81-3053, Leatherby did not contest the arbitrators' basic finding of liability, but challenged the amount of the damage award and made various technical objections to the conduct of the arbitration, including the assertion, which had twice been rejected by the district court, that the arbitrators had failed to apply a set-off against the award (*see, e.g.*, No. 81-3053, Leatherby Br. at vi, 44-48 (filed March 15, 1982)).

D. Leatherby's Second Rule 60(b) Motion.

Leatherby's appeal in No. 81-3053 was fully briefed and set down for argument. On May 12, 1982, two days prior to the scheduled oral argument, Leatherby filed a second Rule 60(b) motion in the district court, this time alleging that it had "recently discovered" that Arbitrator Jack F. Clifford had failed to disclose a past association, as co-employees at an unrelated and long-defunct company, with two of Merit's officers (O.R. Item 94). According to Leath-

erby, the arbitrator's failure to disclose this association, which had terminated 14 years prior to the commencement of the arbitration, constituted "evident partiality" warranting vacation of the award under 9 U.S.C. §10(b). Leatherby moved in the court of appeals to stay oral argument in No. 81-3053, but the panel proceeded with oral argument and took the case under advisement.

The district court subsequently granted an evidentiary hearing on Leatherby's second Rule 60(b) motion (O.R. Item 106). Following that hearing, on September 10, 1982, the district court granted Leatherby's second Rule 60(b) motion, vacated its earlier judgment confirming the arbitration award, and vacated the award (Pet. App. 29). Merit's motion for reconsideration was denied on October 15, 1982 (O.R. Item 137).

Leatherby moved on September 14, 1982, to dismiss its appeal in No. 81-3053, which was then under advisement, having been argued orally four months earlier, or, alternatively, to remand the case to the district court. Thereafter, on November 1, 1982, the court of appeals entered an order in that appeal (No. 81-3053) determining that the district court's orders of September 10 and October 15, 1982, were not final orders, but mere certifications that the district court was disposed to grant Leatherby's second Rule 60(b) motion (Pet. App. 24-25.)[3] The Seventh Circuit therefore

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[3] On October 28, 1982, Merit had filed a notice of appeal from the district court's order of October 15, 1982. That appeal, which was docketed as No. 82-2762, was subsequently dismissed on the same ground that the order of October 15 was not a final order, but merely a certification of the district court's disposition to grant Leatherby's motion.

remanded the case for re-entry of those certifications as orders (Pet. App. 24-25).

On November 4, 1982, the district court entered minute orders granting Leatherby's second Rule 60(b) motion, vacating the judgment confirming the award, vacating the award, and denying Merit's motion for reconsideration (Pet. App. 30; O.R. Item 140).

Although Merit opposed Leatherby's motion to dismiss its appeal in No. 81-3053 ("the first appeal"), on the ground that judicial economy would be served by having that appeal and the appeal from the November 4, 1982 order heard at the same time, the Seventh Circuit granted Leatherby's motion to dismiss its appeal on November 17, 1982 (Pet. App. 26). The Seventh Circuit did so without opinion, but obviously agreed with Leatherby's contention that, as a technical matter, the first appeal (No. 81-3053) could not stand as an independent appeal because the district court had vacated the judgment from which that appeal had been taken. The Seventh Circuit did not intimate any view, of course, as to whether, in any new appeal which might be filed by Merit, Leatherby would be obliged to raise defensively the same grounds which it had raised offensively in the first appeal.

E. Merit's Appeal in No. 82-2885.

On November 23, 1982, Merit perfected appeal No. 82-2885 ("the second appeal") from the orders vacating the award and granting related relief, which the district court had entered on November 4, 1982. Leatherby moved to dismiss Merit's appeal on the ground that an order vacating an arbitration award is not a final order appealable as of right under 28 U.S.C. §1291. After full briefing, the Seventh Circuit denied Leatherby's motion to dismiss on January 27, 1982.

The second appeal was then fully briefed and argued orally. Merit, as appellant, contended that the district court's vacation of the award was erroneous as a matter of law because the undisclosed prior association was insufficient to support a finding of "evident partiality," and because Leatherby had failed in any event to make the minimum showing necessary to justify extraordinary relief under Rule 60(b).[4] For its part, Leatherby argued only that the judgment vacating the award should be affirmed because the undisclosed association mandated vacation of the award. Leatherby did not urge in support of the judgment vacating the arbitration award any of the grounds it had previously urged in the first appeal (No. 81-3053) in seeking reversal of the original judgment confirming the award.

On July 12, 1983, the Seventh Circuit, in a unanimous opinion, reversed the judgment vacating the award and

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[4] The evidence showed that the contacts between Arbitrator Clifford and Mr. Stern, Merit's president, during the two-year period that they were both employed by Cosmopolitan Insurance Company, an unrelated and now-defunct entity, were extremely limited (App. 3-4). For instance, the two men had never had any social contact whatsoever and had never even had a business lunch together (No. 83-653 Pet. App. 29). Although both men had remained active in insurance matters in the City of Chicago, they had had no contact of any kind, professional or social, in the 14 years between Mr. Stern's departure from Cosmopolitan in 1963 and the commencement of the arbitration in 1977 (App. 4). Mr. Clifford's contact with Mr. Rotheiser, one of Merit's vice-presidents and also a former employee of Cosmopolitan, was even more limited (App. 4). Finally, Leatherby's second Rule 60(b) motion was premised upon its "recent discovery" of Mr. Clifford's prior association with Mr. Stern and Mr. Rotheiser, but Leatherby offered no evidence, not even by affidavit, to establish that its officers or directors, as opposed to its trial attorneys, were ever unaware of these associations, either at the time Mr. Clifford was selected to serve as an arbitrator or, indeed, at any time prior to the filing of its second Rule 60(b) motion (*see* App. 16-17).

remanded the case "with directions to reinstate the previous judgment" confirming the arbitration award (App. 1-18). Leatherby's petition for rehearing and suggestion of rehearing en banc were subsequently denied, with no judge in regular active service requesting a vote on Leatherby's suggestion of rehearing en banc (App. 42). This Court denied Leatherby's petition for a writ of certiorari on December 5, 1983 (App. 43).

Following the denial by this Court of Leatherby's petition for a writ of certiorari, the parties returned to the Seventh Circuit, where they briefed certain issues relating to the amount of interest to which Merit was entitled. Those issues were decided by the court of appeals on February 28, 1984. *Merit Ins. Co.* v. *Leatherby Ins. Co.*, 728 F.2d 943 (7th Cir. 1984). On that date, the mandate of the court of appeals issued to the district court, which entered judgment in favor of Merit, pursuant to the instructions contained in the mandate, on March 6, 1984 (Pet. App. 6).

F. Leatherby's Third Rule 60(b) Motion.

On March 15, 1984, Leatherby again moved under Fed. R. Civ. P. 59 and 60(b) for relief from the judgment confirming the arbitration award (O.R. Item 167). In this, its third motion for relief from the judgment, Leatherby incorporated by reference its first Rule 60(b) motion, which had been filed well over two years before. Leatherby's motion was once again based on the arbitrators' purported failure to apply a set-off against the award, the same argument which had twice been rejected by the district court, and which had been urged by Leatherby in its appeal to the court of appeals in No. 81-3053.

The district court carefully considered Leatherby's third motion for extraordinary relief, and, on March 16, 1984, delivered a lengthy opinion from the bench denying

the motion on the ground that Leatherby had not produced any new evidence sufficient to require a hearing (Pet. App. 8-11, 20). On March 16, 1984, Leatherby filed its notice of appeal from the judgment entered pursuant to the mandate of the court of appeals and from the order denying Leatherby's third motion under Rule 60(b) for relief from the judgment (O.R. Item 173).

G. Leatherby's Appeal in No. 84-1427.

On April 6, 1984, Merit moved to dismiss Leatherby's appeal, which had been docketed as No. 84-1427, on the ground that each of the issues which Leatherby might raise on appeal were issues which Leatherby could and should have raised defensively in No. 82-2885, Merit's appeal from the judgment granting Leatherby's second Rule 60(b) motion, vacating the judgment confirming the arbitration award, and vacating the arbitration award.

After full briefing by the parties, the court of appeals granted Merit's motion to dismiss Leatherby's appeal (Pet. App. 1-5), finding Leatherby's appeal to be "frivolous" (Pet. App. 2). The Seventh Circuit stated (Pet. App. 4):

> [W]hen Merit appealed from the district court's order setting aside the arbitration award on the ground of bias of the neutral arbitrator, Leatherby was of course free to defend that order on any ground it wished. For Leatherby to take two bites at the apple, by waiting to see how it fared in defending the district court's grant of its second Rule 60(b) motion before deciding whether to attack the district court's denial of its first motion, and then, after losing in this court, making that denial the subject of another appeal, is an abuse of orderly appellate procedure. See, e.g., *Raxton Corp.* v. *Anania Associates, Inc.*, 668 F.2d 622, 624 (1st Cir. 1982). We shall tolerate no further delay in winding up this protracted litigation, which has

> made a mockery of the promise of arbitration to give those who choose it a swift and effective alternative to judicial dispute resolution.

In view of its finding that the appeal in No. 84-1427 was frivolous, the Seventh Circuit, on its own motion, ordered that Leatherby be required to compensate Merit for the costs and fees which it had reasonably incurred in defending against Leatherby's appeal (Pet. App. 5).

On May 21, 1984, Leatherby filed a petition for rehearing and suggestion of rehearing en banc. That petition was denied on June 4, 1984, with no judge in regular active service having requested a vote on the suggestion of rehearing en banc (Pet. App. 22). On June 6, 1984, Leatherby moved this Court to stay the issuance of mandate by the Seventh Circuit. Leatherby explained its failure to seek such relief from the Seventh Circuit on the ground that that court had already determined that Leatherby's appeal was frivolous and could not therefore be expected to find that the contemplated petition for a writ of certiorari was not "frivolous or filed merely for delay." Seventh Cir. R. 17(a). Justice Stevens denied Leatherby's application for a stay on June 7, 1984 (Pet. App. 23). Thereafter, on June 13, 1984, Leatherby satisfied the judgment enforcing the award by a payment to Merit of principal and interest in the amount of $14,156,505.

The present petition for a writ of certiorari was filed on August 30, 1984.

REASONS FOR DENYING THE WRIT

Leatherby asserts (Pet. 5) that it has been "depriv[ed] of the right . . . to have an appellate resolution of its challenge to an arbitration award in excess of $10,000,000." It is truly extraordinary that Leatherby should now make such an assertion, 12 years after its commission of the fraud underlying this case, and almost four years after the arbitrators' unanimous award in favor of Merit. During the past four years, Leatherby has been afforded numerous opportunities to challenge the award, both in the district court and in the court of appeals. Leatherby, in addition to seeking vacation of the award under 9 U.S.C. §10, has filed no fewer than three motions for relief from the judgment under Fed. R. Civ. P. 60(b). The court of appeals, since the entry of the arbitration award, has heard oral argument in this case on two separate occasions and has written three published opinions. Leatherby has been deprived of no right whatever. On the contrary, its quarrel is with the Seventh Circuit's conclusion that this four-year old litigation, which itself follows three years of arbitration, should finally come to an end.

Contrary to Leatherby's assertion (Pet. 6-8), it was not because Leatherby had voluntarily dismissed its appeal in No. 81-3053 that the Seventh Circuit dismissed Leatherby's appeal in No. 84-1427. The Seventh Circuit did so because Leatherby, as the appellee in No. 82-2885, subsequently eschewed any reliance on the arguments which it had previously raised in No. 81-3053.

Once the district court had entered its November 1982 judgment vacating the arbitration award, Leatherby was obliged by an elementary rule of appellate procedure to

assert, in defending against Merit's appeal from that judgment (No. 82-2885), all of the grounds which it had in the record to support that judgment. Having decided, as a matter of litigation strategy, not to assert in the second appeal the grounds which it had previously urged in the first, Leatherby was properly precluded from doing so in the third. That conclusion is, of course, dictated by sound and well-settled principles of judicial economy. In the case at bar, however, the soundness of that conclusion is buttressed by the fact that this is an arbitration case and therefore subject to only the most limited scope of judicial review.

The petition for a writ of certiorari should be denied, because the decision below is correct and does not conflict with the decisions of any other circuit.

I.

The Court of Appeals Correctly Dismissed Leatherby's Appeal In No. 84-1427.

At the threshold, Leatherby attempts to divert this Court's attention from the question actually decided by the court of appeals by suggesting (Pet. 6-8) that that court penalized Leatherby for voluntarily dismissing its appeal in No. 81-3053. That suggestion is wide of the mark. The Seventh Circuit dismissed Leatherby's appeal in No. 84-1427, not because Leatherby had voluntarily dismissed its appeal in No. 81-3053, but because, on Merit's appeal from the district court's judgment vacating the arbitration award, Leatherby chose not to rely for affirmance on any of the grounds which had previously been rejected by the district court and which Leatherby had urged on its appeal in No. 81-3053. Although each of those other grounds could have been urged in support of the judgment, Leatherby chose to rely only upon the ground on which it had finally prevailed in the district court.

Once the district court had vacated the arbitration award on Leatherby's second Rule 60(b) motion, "Leatherby was of course free," as the Seventh Circuit held, "to defend that order on any ground it wished" (Pet. App. 4).

The Seventh Circuit was merely applying a well-established principle of appellate procedure which is based upon the federal policy against piecemeal appeals. Justice Brandeis stated that principle more than 60 years ago in *United States* v. *American Railway Express Co.*, 265 U.S. 425, 435 (1924) (footnote omitted):

> [T]he appellee may, without taking a cross-appeal, urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court or an insistence upon matter overlooked or ignored by it.

This Court, of course, has frequently applied this sound and well-settled principle. *See, e.g., Massachusetts Mut. Life Ins. Co.* v. *Ludwig*, 426 U.S. 479, 480-81 (1976) (in seeking affirmance, appellee may "attack . . . the reasoning of the lower court"); *Morley Construction Co.* v. *Maryland Cas. Co.*, 300 U.S. 185, 191 (1937) ("The rule is inveterate and certain"). *See also Dandridge* v. *Williams*, 397 U.S. 471, 475 n.6 (1970); 9 Moore's Federal Practice ¶204.11[3] at 4-45 to 4-48 (2d ed. 1983).

As the court of appeals clearly recognized, the considerations of judicial economy which informed this Court's decision in *American Railway Express Co.* more than 60 years ago apply with even greater force today. Given the press of business legitimately brought before the federal courts, attempts at piecemeal appeals such as that pursued here by Leatherby cannot be tolerated.

Thus, there is no substance whatever to Leatherby's implication (Pet. 5) that it has been deprived of the right to assert the grounds that the court of appeals refused to

permit it to assert in the third appeal.[5] Those grounds could have been asserted in the second appeal to defend the district court's judgment in Leatherby's favor. Leatherby may well have recognized that those grounds were far weaker than the one on which it had prevailed in the district court on its second Rule 60(b) motion, and Leatherby may have believed that renewing those earlier arguments would have undercut its credibility in defending the judgment in No. 82-2885. But those were considerations of litigation strategy. While Leatherby was entitled to act on such considerations, it must now live with the consequences. As the Seventh Circuit stated (Pet. App. 4):

> For Leatherby to take two bites at the apple, by waiting to see how it fared in defending the district court's grant of its second Rule 60(b) motion before deciding whether to attack the district court's denial of its first motion, and then, after losing in this court, making that denial the subject of another appeal, is an abuse of orderly appellate procedure.

At one point in its petition, Leatherby apparently concedes (Pet. 9) that it *could* have urged in the second appeal the grounds which it attempted to raise in the third, but says that it was not *required* to do so (Pet. 9-10). Leatherby's position is not supported by any relevant authority (*see* pages 18-20, *infra*), and it is directly contrary to the First Circuit's decision in *Raxton Corp.* v. *Anania Associates, Inc.*, 668 F.2d 622 (1982), upon which the court of appeals relied here (Pet. App. 4). In *Raxton*,

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[5] Leatherby spelled out this argument in its brief to the court of appeals in No. 84-1427, in which it stated that "[d]ue to the unusual procedural history of this case, until this date, [Leatherby] has been *unable* to pursue resolution of those issues [raised in No. 81-3053] on appeal" (No. 84-1427, Leatherby Br. at 20 (filed April 19, 1984) (emphasis added)).

Chief Judge Coffin stated (668 F.2d at 624; citations omitted):

> It is not open to question that an appellee as [the plaintiff] was, should, in supporting a judgment below, challenge any finding or conclusion or absence thereof that it deems error as revealed by the record. The presentation on appeal of all viable justifications of a judgment ensures that simpler and speedier bases for decision are not overlooked, that occasions for remand are minimized, and that issues that may have appeared as independent alternatives to a trial court can be considered as mutually supporting interdependent parts of an appellate decision.

See also Alioto v. *Cowles Communications, Inc.*, 623 F.2d 616, 618 (9th Cir. 1980) (defendant's failure to challenge special verdict on first appeal constituted waiver of issue on second appeal), *cert. denied*, 449 U.S. 1102 (1981); *Richardson* v. *Communications Workers of America*, 486 F.2d 801, 804 (8th Cir. 1973) (defendants' failure to preserve defenses in a motion for directed verdict "and their total abandonment of these issues on the original appeal" precluded their being raised in subsequent proceedings).

The rule stated in *Raxton* is based on the policy against piecemeal appeals, which in turn rests on considerations of judicial economy. The policy underlying the rule would be poorly served, and the rule would be no rule at all, if compliance with it were optional. Moreover, the two grounds upon which Leatherby relies in asserting that such compliance is optional are simply unpersuasive. First, Leatherby asserts (Pet. 9) that it was not required to renew its arguments in No. 82-2885 because there was no extant adverse judgment and, thus, no cross-appeal was available to it. Second, Leatherby asserts (Pet. 9-10) that "it is inconsistent and illogical to hold that an appellee *must* . . . raise issues going to the impropriety of a non-

existent judgment, from which no appeal or cross-appeal is jurisdictionally possible, in the context of defending an order setting aside the judgment on wholly unrelated grounds'' (emphasis in original; footnote omitted).

Each of these arguments is beside the point, because each ignores the fact that the district court, by entering a judgment vacating the arbitration award, had granted the very relief which Leatherby sought. The judgment was in Leatherby's favor, and ''[i]t is the judgment and not what else may have been said by the lower court that is on appeal to a court of review.'' *Material Service Corp.* v. *Dep't of Revenue*, 98 Ill.2d 382, 387, 457 N.E.2d 9, 12 (1983). *Accord, J.E. Riley Investment Co.* v. *Commissioner*, 311 U.S. 55, 59 (1940) (''Where the decision below is correct it must be affirmed by the appellate court though the lower tribunal gave a wrong reason for its action''). There was no need for Leatherby to file a cross-appeal. Leatherby was entitled to defend the judgment vacating the award on any ground appearing in the record, including those which the district court had explicitly rejected. Moreover, as *Raxton* teaches, it was incumbent upon Leatherby to urge each of those grounds if it wished to rely upon them to sustain the judgment vacating the award.

Indeed, Leatherby offers no real excuse for failing to raise these issues in No. 82-2885. The closest it comes to doing so is to assert (Pet. 11) that that course would have been ''wasteful'' because it would have required the briefing in No. 82-2885 of issues that need not have been reached if the court of appeals had affirmed the judgment vacating the award on the ground adopted by the district court. Understandably, Leatherby does not dwell on that point because it is far from clear how it would have been ''wasteful'' for Leatherby to have raised those issues in No. 82-2885, particularly when it could have

done so by standing on the briefs that already had been printed and filed in No. 81-3053. What *was* wasteful, as the court of appeals succinctly stated, was "[f]or Leatherby to take two bites at the apple, by waiting to see how it fared in defending [in No. 82-2885] the district court's grant of its second Rule 60(b) motion before deciding whether to attack the district court's denial of its first motion, and then, after losing in this court, making that denial the subject of another appeal. . ." (Pet. App. 4).

As the court of appeals noted (Pet. App. 4), these principles apply with special force in the instant case because ordinary principles of judicial economy are here buttressed by the public policy of the Federal Arbitration Act, 9 U.S.C. §1 *et seq.*, and the narrow scope of judicial review available under that statute. Leatherby, as the losing party to an arbitration which it had specifically demanded, has managed, by filing no fewer than three motions for extraordinary relief under Rule 60(b), to drag a unanimous arbitration award (which itself was the product of an arbitration that spanned three years and 120 sessions) through almost four years of subsequent litigation.

Leatherby's efforts have plainly "frustrate[d] the salutary purpose of arbitration" (*U.S. Wrestling Federation* v. *Wrestling Division of AAU, Inc.*, 605 F.2d 313, 318 (7th Cir. 1979)), which is to secure a speedy, binding, and inexpensive resolution of disputes. *See Wilko* v. *Swan*, 346 U.S. 427, 431 (1953); *Saxis Steamship Co.* v. *Multifacs International Traders, Inc.*, 375 F.2d 577, 582 (2d Cir. 1967). As the court of appeals aptly concluded (Pet. App. 4), "this protracted litigation . . . has made a mockery of the promise of arbitration to give those who choose it a swift and effective alternative to judicial dispute resolution."

II.

The Decision of the Court of Appeals Does Not Conflict With Any Prior Decision of Any Other Circuit.

Leatherby contends (Pet. 11-14) that review should be granted in this case because the decision below conflicts with the decisions of two other circuits and with the Seventh Circuit's own decision in a prior case. That contention clearly lacks merit.

In asserting the existence of a conflict among the circuits, Leatherby places principal reliance upon the Fifth Circuit's decision in *Conway* v. *Chemical Leaman Tank Lines, Inc.*, 644 F.2d 1059 (1981). The decision in *Conway* is clearly distinguishable from the case at bar. In that case, the district court had "granted a new trial on one of two grounds urged by the plaintiffs' motion, after the appellate court had reversed an earlier grant of a new trial based upon *another* ground urged by the plaintiffs' motion" (644 F.2d at 1060; emphasis in original). In finding that the plaintiffs were not precluded from renewing that ground on remand to the district court, and that the district court had not erred in accepting that ground, the Fifth Circuit pointed out that "neither *trial* nor appellate court had previously passed upon the ground for a new trial now relied upon by the district court" (*id.*; emphasis added). The Fifth Circuit further noted that "a cross-appeal by the plaintiffs would have raised an issue not decided by the district court that, in all likelihood, would not have been considered by the appellate court [on the previous appeal], at least without further remand to the trial court for initial decision" (*id.* at 1062).

The case at bar is thus distinguishable from *Conway* in three fundamental respects. First, the issue involved in

Conway—whether a new trial should be granted because of allegedly prejudicial trial error—is one peculiarly within the competence of the trial judge and is determined by the exercise of his discretion; his determination will not be reversed absent a clear abuse of discretion. *See, e.g. Delta Engineering Corp.* v. *Scott,* 322 F.2d 11, 15-16 (5th Cir. 1963), *cert. denied,* 377 U.S. 905 (1964). As the Fifth Circuit recognized in the passage quoted above, such an issue must be passed on by the trial judge in the first instance.

Second, there was no question in the case at bar of Leatherby's seeking appellate review of grounds which had not been addressed by the district court. In the case at bar, the district court had already exhaustively considered and rejected each of the grounds which Leatherby elected not to assert in defense of the judgment in its favor in No. 82-2885.

Third, there was no question of the necessity for a cross-appeal in the instant case, because the district court had entered a judgment vacating the arbitration award, and, as we have shown (*see* pages 12-17, *supra*), Leatherby was entitled, without any necessity for filing a cross-appeal, to support that judgment on any ground supported by the record.

Leatherby's reliance (Pet. 12-13) on the Tenth Circuit's decision in *Garcia* v. *Regents of the University of California,* 737 F.2d 889 (1984), is equally misplaced. In that case, the Tenth Circuit simply adopted the procedure that was followed by the Seventh Circuit in the case at bar, that is, to allow the district court to indicate whether it is disposed to grant a Rule 60(b) motion prior to deciding whether to dismiss an existing appeal from the original judgment. *See* pages 5-6, *supra.* The decision in *Garcia*

does not address the question whether the moving party, having prevailed on a Rule 60(b) motion in the district court, should be required on appeal to defend that judgment on all of the grounds available in the record or be able to save some of its arguments for "a second bite at the apple" (Pet. App. 4).

Finally, Leatherby's reliance (Pet. 13-14) on an alleged conflict between the decision below and the Seventh Circuit's prior decision in *Drinan* v. *A. J. Lindemann & Hoverson Co.*, 238 F.2d 72 (1956), is misplaced. It is well-established that this Court will not grant review for the purpose of resolving an intra-circuit conflict. *See, e.g., Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) ("It is primarily the task of a Court of Appeals to reconcile its internal difficulties"). That is the purpose to be served by a suggestion of rehearing en banc, which was made and denied in the case at bar. In any event, *Drinan* was decided almost 30 years ago, and, to whatever extent the reasoning in *Drinan* may be inconsistent, as Leatherby asserts (Pet. 14), with the First Circuit's reasoning in *Raxton Corp.* v. *Anania Associates, Inc.*, 668 F.2d 622 (1982), upon which the Seventh Circuit explicitly relied in the case at bar (*see* Pet. App. 4), it is not surprising that the Seventh Circuit should have preferred *Raxton* as a more persuasive statement of modern legal principles in this area.

III.

The Court of Appeals Properly Awarded Damages Under Fed. R. App. P. 38 and the Making of That Award Raises No Question Warranting Review by This Court in Any Event.

Leatherby contends (Pet. 15) that the Seventh Circuit erred in granting costs and attorneys fees, on its own motion, to Merit. Although that court carefully limited the

award to the costs and fees which Merit incurred in moving to dismiss the appeal in No. 84-1427, Leatherby asserts that it was error to impose any sanctions at all because both parties contemplated that an appeal would be filed by Leatherby if the arbitration award were reinstated in No. 82-2885. That both parties may have contemplated that event does not, of course, establish that the appeal was not frivolous. Indeed, Merit's prediction that a further appeal would be filed was based on Leatherby's conduct throughout this litigation, which has been to seize every conceivable opportunity, whether justified or not, "to delay," as the Seventh Circuit suggested, "the final day of reckoning when Leatherby has to pay the judgment that has been entered against it" (Pet. App. 3). The fact that Merit accurately predicted Leatherby's continued recalcitrance cannot create the estoppel which Leatherby suggests.

At all events, Leatherby's argument must fail because the granting of an award under Rule 38 rests in the sound discretion of the appellate court. *See Ruderer* v. *Fines,* 614 F.2d 1128, 1132 (7th Cir. 1980). *See also* Advisory Committee Note to Rule 38, 43 F.R.D. 155 (1968). The panel which granted this relief on the third appeal was the same panel that decided the second. That panel obviously was well-situated to determine whether Leatherby should have raised in the second appeal the arguments which it later attempted to raise in the third, and it was equally well-situated to determine whether Leatherby's election to pursue yet another appeal, in lieu of raising those grounds in the second, constituted an abuse of the appellate process warranting the imposition of sanctions. In finding that Leatherby had abused the appellate process (Pet. App. 4), the Seventh Circuit clearly found that Leatherby's appeal in No. 84-1427 was "'something more . . . than [merely] an unsuccessful appeal.'" *Ruderer* v.

Fines, 614 F.2d at 1132, *quoting, NLRB* v. *Lucy Ellen Candy Div.,* 517 F.2d 551, 555 (7th Cir. 1975).

The Seventh Circuit's decision in the case at bar is clearly consistent with its prior decision in *Ruderer,* and there is no basis whatever for asserting that the Seventh Circuit abused its discretion here. That the district court, from its own vantage point, may have taken a different view of Leatherby's appellate machinations (*see* Pet. 16) is wholly immaterial. In any event, as Leatherby implicitly admits by failing to cite any contrary authority, there is no conflict among the circuits on this point warranting review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Dated: September 21, 1984

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APPENDIX

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APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

No. 82-2885

MERIT INSURANCE COMPANY,

Plaintiff-Appellant,

v.

LEATHERBY INSURANCE COMPANY a/k/a WESTERN EMPLOYERS INSURANCE COMPANY,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 80 C 6758—Charles P. Kocoras, *Judge.*

ARGUED MAY 31, 1983—DECIDED JULY 12, 1983

Before CUMMINGS, *Chief Judge,* POSNER, *Circuit Judge,* and FAIRCHILD, *Senior Circuit Judge.*

POSNER, *Circuit Judge.* This appeal from an order under Rule 60(b) of the Federal Rules of Civil Procedure setting aside an arbitration award requires us to decide whether the failure of one of the arbitrators to disclose a prior business relationship with a principal of one of the parties to the arbitration justified the district court in using its powers under Rule 60(b) and the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, to set aside the award.

In 1972 Merit Insurance Company made a contract with Leatherby Insurance Company to reinsure claims under certain insurance policies that Leatherby had issued. Merit later sued Leatherby in federal district court for fraud in inducing the contract. Jurisdiction was based on diversity of citizenship. Leatherby moved the court for an order under 9 U.S.C. § 4 directing the parties to arbitrate their dispute in accordance with the arbitration clause in the contract, and in 1977 the district court entered such an order. See *Merit Ins. Co.* v. *Leatherby Ins. Co.*, 581 F.2d 137, 139 (7th Cir. 1978), and for collateral litigation *Merit Ins. Co.* v. *Colao*, 603 F.2d 654 (7th Cir. 1979).

The arbitration was conducted under the auspices of the American Arbitration Association. Each party appointed one arbitrator and together the parties appointed from a list formulated by the AAA the third or "neutral" arbitrator, a Chicago lawyer named Jack Clifford. At the first meeting of the arbitration panel the panel agreed that the other two arbitrators would also be neutrals, rather than representatives of the parties that had appointed them.

After an arbitration that lasted three years and produced a hearing transcript of 16,000 pages, the panel on December 1, 1980, unanimously awarded Merit $10,675,000 on its claim. Merit petitioned the district court to confirm the award under 9 U.S.C. § 9. Leatherby opposed confirmation in part on the ground that the arbitrators had been biased, as indicated by certain evidentiary rulings in Merit's favor and by a comment the arbitrator appointed by Merit had made in the course of the proceedings. No charge of bias was leveled against Clifford specifically. The district judge rejected all of Leatherby's arguments and on November 19, 1981, confirmed the award. A month later he rejected Leatherby's first motion under Rule

60(b) to set it aside. Leatherby appealed to this court from both the order confirming the award and the order denying the Rule 60(b) motion. On May 12, 1982, while the appeal was pending, Leatherby filed a second Rule 60(b) motion, this one based on Leatherby's alleged discovery the previous month that Clifford had once worked under Merit's president and principal stockholder, Jerome Stern, at Cosmopolitan Insurance Company. The appeal was dismissed on Leatherby's motion, and an evidentiary hearing on its new charge of bias was held in the district court at the end of August. On November 4, 1982, in an oral opinion, the court granted Leatherby's Rule 60(b) motion and set aside the arbitration award, and Merit has appealed under 28 U.S.C. § 1291. See *University Life Ins. Co. of America* v. *Unimarc Ltd.*, 699 F.2d 846, 848 (7th Cir. 1983).

The hearing in the district court brought out the following facts. The chairman of the board of Cosmopolitan had hired Clifford late in 1960 to be head of the claims department. At the same time Stern had been promoted to executive vice-president of the company. As the vice-president in charge of the claims department Clifford reported to Stern. This relationship lasted till the beginning of 1963 when Stern left Cosmopolitan to enter private practice. Clifford left Cosmopolitan shortly afterward. Clifford and Stern both testified that they had had little professional contact while at Cosmopolitan and no social contacts then or since. Clifford had been promised substantial autonomy by the chairman of the board when he took over the claims department, and Stern—who had no background in claims evaluation and was preoccupied with corporate acquisitions and other matters unrelated to Clifford's responsibilities—gave Clifford a loose rein. Their principal contact came in meetings held at intervals of several months between Stern and the department

heads who reported to him. They also had occasional brief discussions over specific claims; once Clifford was asked to review the claims reserves of an insurance company that Cosmopolitan was thinking of buying; and, on orders from above, Stern once required all of his subordinates, including Clifford, to take lie-detector tests. After Clifford and Stern entered private practice they spoke to each other on the phone on one or two occasions but these contacts were of no significance, and until the arbitration the two men had not met face to face since 1963. Rotheiser, a vice-president of Merit, was also employed at Cosmopolitan during Clifford's tenure, but he was the head of a separate department and according to both his testimony and Clifford's they had no dealings with one another.

The foregoing account is drawn in large part from the testimony of Clifford himself, of whom the district judge stated, "I do not find Mr. Clifford to be a credible witness." But read in context this statement principally refers not to Clifford's testimony about his time at Cosmopolitan—testimony corroborated by Stern and Rotheiser, whom the district judge did not find to be incredible and who were not contradicted by any other witness—but to Clifford's explanation of why he omitted to mention his affiliation with Cosmopolitan either when he filled out the forms that the American Arbitration Association requires from its prospective arbitrators or when he first saw Stern at the arbitration hearing. In 1975 the AAA had sent Clifford a "panel data sheet" which contained a space headed, "My prior occupational affiliations have been . . . ." All that Clifford listed in this space (having listed private practice as his current occupation) was his job as claims manager for Fireman's Fund American Insurance Companies from 1949 to 1960. Clifford testified that he had not mentioned Cosmopolitan in part because he was not interested in doing the kind of arbitration for

which his experience there would have been relevant. The judge disbelieved this because it was the same kind of work Clifford had done at Firemen's Fund. (The judge made no comment on Clifford's other, and more plausible, explanation for not mentioning his work for Cosmopolitan: it was not a useful reference. Since the company had been liquidated, getting an evaluation of Clifford's work for the company would have been difficult.) But the judge could not have believed that the purpose of the omission was to prevent Clifford from being disqualified as an arbitrator, for the Merit-Leatherby arbitration was still two years in the future when Clifford mailed back the form. The judge conjectured, rather, that Clifford had been embarrassed to broadcast his relationship with Cosmopolitan, because after he had left it the company had gone broke, which resulted, in the district judge's words, in "an explosion in the industry." But when Clifford filled out another panel data sheet at the AAA's request three years later, he again omitted any reference to his work at Cosmopolitan; and when the arbitration began and Clifford recognized Stern and realized that the president of Merit and the former executive vice-president of Cosmopolitan were one and the same, he had said nothing.

Leatherby argues that by failing at each of these junctures to disclose his former relationship with Stern, Clifford violated the ethical norms applicable to arbitrators, and that the only effective sanction for such a violation is to set aside the arbitration award. It also argues that Clifford did more than just fail to disclose his former relationship with Stern, that he tried to put Leatherby off the scent by calling Stern "Mr. Stern" rather than calling him by his first name; but there is no evidence that Clifford was doing anything other than maintaining the decorum of the arbitration proceeding.

The panel data sheet that the American Arbitration Association requires prospective arbitrators to fill out does not indicate that the information sought is for the purpose of determining whether grounds for disqualification exist, so no significance can be attached to Clifford's initial omission of his job history with Cosmopolitan. But section 18 of the AAA's Commercial Arbitration Rules requires the neutral arbitrator to "disclose to the AAA any circumstances likely to affect his impartiality, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their counsel." And Canon IIA of the Code of Ethics for Arbitrators in Commercial Disputes (jointly adopted by the American Arbitration Association and the American Bar Association) requires arbitrators to disclose "any existing or past financial, business, professional, family or social relationships which are likely to affect impartiality or which might reasonably create an appearance of partiality or bias." The requirement of disclosure is a continuing one, so the fact that Clifford's failure to disclose his relationship with Cosmopolitan in his first panel data sheet was innocent could not excuse his later failure to disclose the relationship when he accepted appointment as an arbitrator in the Merit-Leatherby dispute and when he recognized Stern on the first day of the arbitration hearing.

Notwithstanding the broad language of section 18, no one supposes that either the Commercial Arbitration Rules or the Code of Ethics for Arbitrators requires disclosure of every former social or financial relationship with a party or a party's principals. The Code states that its provisions relating to disclosure "are intended to be applied realistically so that the burden of detailed disclosure does not become so great that it is impractical for persons in the business world to be arbitrators, there-

by depriving the parties of the services of those who might be best informed and qualified to decide particular types of cases." Quoting from Justice White's concurring opinion in *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145, 150-52 (1968)—of which more anon—the Code states that although "arbitrators 'should err on the side of disclosure' . . . , it must be recognized that 'an arbitrator's business relationships may be diverse indeed, involving more or less remote commercial connections with great numbers of people' [so that] an arbitrator 'cannot be expected to provide the parties with his complete and unexpurgated business biography,' . . . [or] to disclose interests or relationships which are merely 'trivial.'"

The ethical obligations of arbitrators can be understood adjudication by arbitrators and adjudication by judges and jurors. No one is forced to arbitrate a commercial only by reference to the fundamental differences between dispute unless he has consented by contract to arbitrate. The voluntary nature of commercial arbitration is an important safeguard for the parties that is missing in the case of the courts. See *Corey* v. *New York Stock Exchange*, 691 F.2d 1205, 1210 (6th Cir. 1982). Courts are coercive, not voluntary, agencies, and the American people's traditional fear of government oppression has resulted in a judicial system in which impartiality is prized above expertise. Thus, people who arbitrate do so because they prefer a tribunal knowledgeable about the subject matter of their dispute to a generalist court with its austere impartiality but limited knowledge of subject matter. "The professional competence of the arbitrator is attractive to the businessman because a commercial dispute arises out of an environment that usually possesses its own folkways, mores, and technology. Most businessmen interviewed contended that commercial disputes should be considered

within the framework of such an environment. No matter how determinedly judge and lawyer work to acquire an understanding of a given business or industry, they cannot hope to approximate the practical wisdom distilled from 30 to 40 years of experience." American Management Ass'n, Resolving Business Disputes 51 (1965).

There is a tradeoff between impartiality and expertise. The expert adjudicator is more likely than a judge or juror not only to be precommited to a particular substantive position but to know or have heard of the parties (or if the parties are organizations, their key people). "Expertise in an industry is accompanied by exposure, in ways large and small, to those engaged in it . . . ." *Andros Compania Maritima, S.A.* v. *Marc Rich & Co.*, 579 F.2d 691, 701 (2d Cir. 1978). The different weighting of impartiality and expertise in arbitration compared to adjudication is dramatically illustrated by the practice whereby each party appoints one of the arbitrators to be his representative rather than a genuine umpire. See Note, *The Use of Tripartite Boards in Labor, Commercial, and International Arbitration*, 68 Harv. L. Rev. 293 (1954). No one would dream of having a judicial panel composed of one part-time judge and two representatives of the parties, but that is the standard arbitration panel, the panel Leatherby chose—presumably because it preferred a more expert to a more impartial tribunal—when it wrote an arbitration clause into its reinsurance contract with Merit.

If Leatherby had wanted its dispute with Merit resolved by an Article III judge (to whom it had access under the diversity jurisdiction), it would not have inserted an arbitration clause in the contract, or having done so move for arbitration against Merit's wishes. Leatherby wanted something different from judicial dispute resolution. It

wanted dispute resolution by experts in the insurance industry, who were bound to have greater knowledge of the parties, based on previous professional experience, than an Article III judge, or a jury. The parties to an arbitration choose their method of dispute resolution, and can ask no more impartiality than inheres in the method they have chosen. Cf. *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944) (L. Hand, J.).

It is no surprise, therefore, that the standards for disqualification in the Commercial Arbitration Rules and the Code of Ethics for Arbitrators are not so stringent as those in the federal statutes on judges, see, e.g., 28 U.S.C. § 455, or in Canons 2 and 3(C) of the Code of Judicial Conduct for United States Judges and the ABA's Code of Judicial Conduct. (In fact the arbitration rules and code do not contain any standards for disqualification as such, though such standards are implicit in the disclosure requirements of the AAA's Rules and the AAA-ABA Code.) We thus do not agree with Leatherby that the test for disqualification here is whether the former relationship between Stern and Clifford was "trivial" in relation to the subject matter of the arbitration. If it were trivial Clifford would not have had to disqualify himself even if he had been a judge. See, e.g., *Chitimacha Tribe of Louisiana* v. *Harry L. Laws Co.*, 690 F.2d 1157, 1166 (5th Cir. 1982); *United States Fidelity & Guaranty Co.* v. *Lawrenson*, 334 F.2d 464, 466 (4th Cir. 1964); Interim Advisory Committee on Judicial Activities, Advisory Opinion No. 11 (Jan. 21, 1970), in Code of Judicial Conduct for United States Judges at p. II-26 ("It cannot be that [law] firms are precluded from practice before judges simply because members have judges for friends. Here again there may be special circumstances dictating disqualification, but a friendly relationship is not sufficient reason in itself").

Maybe it was trivial. *Chitimacha* held that a district judge did not have to disqualify himself from a case in which the defendant was a corporation that the judge had represented when he was in private practice, since the representation had terminated at least six years before. That was a professional relationship, like Clifford's with Stern—only a more recent one. But the test in this case is not whether the relationship was trivial; it is whether, having due regard for the different expectations regarding impartiality that parties bring to arbitration than to litigation, the relationship between Clifford and Stern was so intimate—personally, socially, professionally, or financially—as to cast serious doubt on Clifford's impartiality. Although Stern had been Clifford's supervisor for two years and was a key witness in an arbitration where the stakes to the party of which he was the president and principal shareholder were big, their relationship had ended 14 years before, Clifford had no possible financial stake in the outcome of the arbitration, and his relationship with Stern during their period together at Cosmopolitan had been distant and impersonal. The fact that they had never socialized, either while working for the same company or afterward (though both were practicing law in Chicago all this time), indicates a lack of intimacy. And when a former employee sits in judgment on a former employer there is no presumption that he will be biased in favor of the former employer; he may well be prejudiced against him. The fact that Clifford passed his lie-detector test with flying colors might have made him grateful to Stern, or might have fanned the flames of outrage at having been subjected to such an indignity, or more likely made no difference at all because it happened so long ago. Time cools emotions, whether of gratitude or resentment.

Section 18 of the Commercial Arbitration Rules makes the AAA itself the final arbiter of disqualification once the arbitrator has been appointed, subject only (so far as relevant here) to the limited judicial review allowed by section 10 of the Arbitration Act, 9 U.S.C. § 10, after an arbitration award is made and judicial confirmation of it sought. On the basis of the facts reviewed above, considered in the light of the less stringent standards applicable to disqualification of arbitrators than to disqualification of judges, we doubt that the AAA would have disqualified Clifford—or that Leatherby would have wanted it to.

But even if the failure to disclose was a material violation of the ethical standards applicable to arbitration proceedings, it does not follow that the arbitration award may be nullified judicially. Although we have great respect for the Commercial Arbitration Rules and the Code of Ethics for Arbitrators, they are not the proper starting point for an inquiry into an award's validity under section 10 of the United States Arbitration Act and Rule 60(b) of the Federal Rules of Civil Procedure. The arbitration rules and code do not have the force of law. If Leatherby is to get the arbitration award set aside it must bring itself within the statute and the federal rule. The statute specifies limited grounds for setting aside an arbitration award. The only one relevant here is, "Where there was evident partiality or corruption in the arbitrators, or either of them." 9 U.S.C. § 10(b). (Leatherby does not argue that the award can be set aside on any other ground in the statute, such as "misbehavior" of an arbitrator, in section 10(c).) This is strong language. It makes the grounds for setting aside an arbitrator's award because of bias narrower than the grounds for disqualification in the arbitration rules and code, not to mention the statutes and ethical codes pertaining to judges. Read

literally, section 10(b) would require proof of actual bias ("evident partiality"). And not only the arbitrator appointed by Merit, as one might expect, but also the arbitrator appointed by Leatherby—a member of a distinguished Chicago law firm—gave a detailed affidavit denying absolutely and in detail that Clifford had ever evinced any partiality during the three years of the arbitration.

Of course actual bias might be present yet impossible to prove; Clifford might have given no indication of his vote yet have been irrevocably committed to Merit out of some obscure sense of gratitude toward, or exaggerated respect for, Stern. If circumstances are such that a man of average probity might reasonably be suspected of partiality, maybe the language of section 10(b) can be stretched to require disqualification. But the circumstances must be powerfully suggestive of bias, and are not here.

The American Arbitration Association is in competition not only with other private arbitration services but with the courts in providing—in the case of the private services, selling—an attractive form of dispute settlement. It may set its standards as high or as low as it thinks its customers want. The statute has a different purpose—to make arbitration effective by putting the coercive force of the federal courts behind arbitration decrees that affect interstate commerce or are otherwise of federal concern. See 9 U.S.C. § 1; S. Rep. No. 536, 68th Cong., 1st Sess. 3 (1924). The statute does not provide a dispute settlement mechanism; it facilitates private dispute settlement. The standards for judicial intervention are therefore narrowly drawn to assure the basic integrity of the arbitration process without meddling in it. Section 10 is full of words like corruption and misbehavior and fraud. The standards it sets are minimum ones. The ethical concerns expressed by Leatherby are remote from the draftsmen's concerns. The Senate Report, for example,

refers approvingly to " 'arrangements for avoiding the delay and expense of litigation and referring a dispute to friends . . . .' " S. Rep. No. 536, *supra*, at 3. The fact that the AAA went beyond the statutory standards in drafting its own code of ethics does not lower the threshold for judicial intervention. If Clifford violated current ethical norms for commercial arbitrators, his was at worst a technical violation that does not justify setting aside an arbitration award on the statutory ground of evident partiality or corruption. Concern with professional reputation will provide some deterrent to such violations, especially where the arbitrator is a lawyer, as he was here.

We have discussed the issue of the award's validity as if it had to be decided on the basis of first principles—as it very largely does. Prior cases involve factual situations very different from the one here and do not yield general principles. The only Supreme Court decision, *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968), provides little guidance because of the inability of a majority of Justices to agree on anything but the result. Justice Black, joined by three other Justices, took a very hard line on the ehtical standards of arbitrators. His opinion contains language suggesting that arbitrators are subject to the same ethical standards as judges, although this is dictum because the facts of the case required disqualification even under a narrow reading of section 10(b): the "neutral" arbitrator was a regular supplier of one of the parties to the arbitration, and had even rendered services on projects involved in the arbitration. Justice White, concurring, purported to join Justice Black's opinion but actually took a quite different tack, the sense of which is captured in the passages we quoted earlier from the Code of Ethics for Arbitrators—which treats Justice White's opinion as a surer guide to the view of a majority of the Su-

preme Court than Justice Black's. Justice White stated, "The Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges," 393 U.S. at 150, and since his vote was essential to a majority, what he said the Court did not decide the Court did not decide, whatever Justice Black may had hoped. Our court, in *United States Wrestling Federation* v. *Wrestling Division of AAU, Inc.*, 605 F.2d 313, 319 (7th Cir. 1979), treated Justice White's opinion as authoritative.

Although it is difficult to extract from the cases more than a mood, the mood is one of reluctance to set aside arbitration awards for failure of the arbitrator to disclose a relationship with a party. See, e.g., *Andros Compania Maritima, S.A.* v. *Marc Rich & Co., supra,* 579 F.2d at 700. In *Andros,* the arbitration award was confirmed although the neutral arbitrator, Nelson, had not disclosed that he had in the recent past sat on 19 arbitration panels with the president of one of the firms involved in the arbitration and in 12 of these panels the president had been one of the arbitrators who had selected Nelson to be the neutral. Disqualification of the neutral arbitrator was also rejected in *International Produce, Inc.* v. *A/S Rosshavet,* 638 F.2d 548, 551 (2d Cir. 1981), even though, during the arbitration, he had been a witness in another case between the same law firms that were trying the artration matter before him. In *Middlesex Mutual Ins., Co.* v. *Levine,* 675 F.2d 1197 (11th Cir. 1982) (per curiam), an arbitration award was set aside for "evident partiality," but there a company owned by the neutral arbitrator's family was entangled in a dispute with the parties to the litigation in which he personally had lost $85,000, and he also was under investigation for alleged unethical conduct involving those parties.

The suggestion in *Tamari* v. *Bache Halsey Stuart, Inc.*, 619 F.2d 1196 (7th Cir. 1980), that "appearance of bias" is a proper standard for disqualification of arbitrators is not inconsistent with anything in our present opinion; it just means that it is unnecessary to demonstrate—what is almost impossible to demonstrate—that the arbitrator has an actual bias. The standard is an objective one, but less exacting than the one governing judges.

Finally, it is significant that the issue of disqualification was raised here by a Rule 60(b) motion to set aside the award, filed some 18 months after the award had been issued by the arbitration panel (though only six months after it was confirmed by the district court). We asked Leatherby's counsel at oral argument whether he thought it would make a difference in this case if the Rule 60(b) motion had come 10 years after the award, with everything else in the case remaining the same. He said it would not. The framers of Rule 60(b) set a higher value on the social interest in the finality of litigation. A motion under Rule 60(b) seeks an extraordinary remedy, *DiVito* v. *Fidelity & Deposit Co. of Maryland*, 361 F.2d 936, 938 (7th Cir. 1966), especially, where as in this case the motion is based on the catch-all provision of Rule 60(b), Rule 60(b)(6) ("any other reason justifying relief from the operation of the judgment"). *Ackermann* v. *United States*, 340 U.S. 192, 200 (1950); *Stradley* v. *Cortez*, 518 F.2d 488, 493 (3rd Cir. 1975); *Naxon Telesign Corp.*, v. *GTE Information Systems, Inc.* 89 F.R.D. 333, 337 (N.D. Ill. 1980); 11 Wright & Miller, Federal Practice and Procedure § 2857, at p. 160 (1973). (Leatherby does not argue that Merit's failure to disclose Stern's former relationship with Clifford was fraud under Rule 60(b)(3).) To make out a case for relief from judgment under Rule 60(b)(6) Leatherby had to show not only that an arbitrator had violated the ethical and legal standards for arbitrators but that the violation created a substantial danger of an unjust result.

It failed to show this. Its counsel conceded at oral argument that his client would be bound to submit to a new arbitration proceeding if the award were set aside. But in the old proceeding Leatherby's own arbitrator voted against it. If we may believe that arbitrator's affidavit—and there is no reason not to—he did not regard this as a close case. According to the affidavit, both he and Merit's arbitrator pushed Merit's case harder than Clifford did. We need not decide whether Clifford was bending over backwards to avoid showing partiality toward Merit in view of his former relationship with Stern or whether, as the affidavits and his own testimony suggest, he is of a retiring disposition and had less experience in the subject matter of the arbitration than the other two arbitrators. It is enough to note that rerunning the arbitration before a different panel is unlikely to change the outcome.

Furthermore, as it is likely that if Leatherby had known about Clifford's former relationship with Stern it would not have cared, because it would not have been able to figure out any more than we can how that relationship would cut in terms of partiality toward or prejudice against Merit, we think Leatherby was required, and it failed, to support its Rule 60(b) motion with affidavits that its officers did not know of the relationship. It had to negate any inference that it had implicitly consented to have Clifford as an arbitrator knowing all it now knows but saying nothing. We note in this regard the perfunctory investigation that Leatherby made into Clifford's background when the AAA first listed him as a possible arbitrator. Leatherby argues that it would have been burdensome to investigate all 26 names on the list and that it was entitled to trust any potential arbitrator to comply with the AAA's disclosure requirements. It points out that the cost of arbitration will be increased if parties, not being able to trust the disclosure requirements, must conduct elaborate

background investigations. It is true that the disclosure requirements are intended in part to avoid the costs of background investigations. But this is a $10 million case. If Leatherby had been worried about putting its fate into the hands of someone who might be linked in the distant past to the adversary's principal, it would have done more than it did to find out about Clifford. That it did so little suggests that its fear of a prejudiced panel is a tactical response to having lost the arbitration.

We do not want to encourage the losing party to every arbitration to conduct a background investigation of each of the arbitrators in an effort to uncover evidence of a former relationship with the adversary. This would only increase the cost and undermine the finality of arbitration, contrary to the purpose of the United States Arbitration Act of making arbitration a swift, inexpensive, and effective substitute for judicial dispute resolution. This lawsuit is already eight years old. To uphold the district court's vacation of the arbitration award in the absence of evidence of actual or probable partiality or corruption would open a new and, we fear, an interminable chapter in the efforts of people who have chosen arbitration and been disappointed in their choice to get the courts—to which they could have turned in the first instance for resolution of their disputes—to undo the results of their preferred method of dispute resolution.

The judgment of the district court setting aside his earlier judgment confirming the arbitration award in favor of Merit is reversed, and the case is remanded with directions to reinstate the previous judgment.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 80 C 6758

In the Matter of the Arbitration between
MERIT INSURANCE COMPANY,
Petitioner, Counter-respondent

and

LEATHERBY INSURANCE COMPANY, a/k/a
WESTERN EMPLOYERS INSURANCE COMPANY,
Respondent, Counter-petitioner.

MEMORANDUM OPINION

CHARLES P. KOCORAS, District Judge:

This matter comes before the court on the petition of Merit Insurance Company ("Merit") to confirm an arbitration award which was rendered in Chicago on December 1, 1980 in the amount of $10,675,000. The respondent Leatherby Insurance Company ("LIC") moves to vacate, to modify, or to correct that award.

This court cannot and need not recite the entire history of the arbitration proceeding. Three arbitrators of the American Arbitration Association, who have professional backgrounds in law and who are familiar with the insurance industry, took part in the proceedings in Chicago, Illinois. The arbitration endured for three years, proceeded for over 120 sessions, and produced a transcript in excess of 16,000 pages. The arbitrators considered either the live or deposition testimony of more than twenty-five witnesses; thousands of pages of documents, including corporate records and correspondence, were presented at the hearings. The petitioner estimates that the arbitrators

spent more than 1100 hours in independent study during the three year proceeding. For purposes of their motions before this court, the parties have filed more than 180 pages of briefs with over thirty exhibits.

Merit and LIC executed a Reinsurance and Assumption Agreement on October 20, 1972 in New Jersey. In the agreement, Merit reinsured all claims that the insured could make against insurance policies issued by LIC through its "retrospective" agent, General Auto Placement Inc. ("GAP"). The "retrospective agency" between the insurer LIC and the agent GAP determines the agent's commissions by retrospectively computing the profitability of the insurance; in this arrangement, the agent issues his own policies and establishes his own department for the investigation and settlement of claims against the policyholders. After the parties entered into the agreement in October of 1972, Merit effectively stepped into the position of LIC with respect to the insurance policies that had been issued on LIC's behalf by GAP.

The gist of Merit's complaint was that LIC failed to disclose several material facts with respect to the reinsurance transaction and that Merit would not have executed the agreement to reinsure the policies procured by GAP had LIC disclosed the facts. In particular, GAP had continually violated the terms of its retrospective arrangement with LIC by engaging in fraudulent practices such as diverting premiums and closing its claim files prematurely in order to present a false image of its profitability. More important, GAP had failed to make adequate increments to its reserve funds for outstanding insurance claims and it had denied LIC access to its books or records.

According to Merit, LIC's president discovered that GAP's business was deteriorating and that GAP had deceived LIC in 1971. In August of that year, LIC's presi-

dent advised GAP's president, Leonard Lebowitz, to find another insurance carrier that would reinsure the policies at issue. (Merit Brief in Supp. of Pet. to Confirm, pp. 16-17). LIC's president testified that he did not cancel GAP's retrospective arrangement at that time because of his hope that GAP would obtain another carrier to reinsure the GAP business for which LIC was ultimately liable. (Merit Brief, p. 17).

Jerome Stern, president of Merit, was solicited by GAP in April, 1972 to become a new insurance underwriter for GAP's operation. The statements of independent auditors indicated that GAP's business was operated properly and that its loss ratio was favorable. Having reviewed those statements, Mr. Stern met with Mr. Lebowitz in April, 1972. After the meeting, Mr. Stern obtained a favorable report from Dun & Bradstreet on GAP as well as a credit and reinsurance reference. In view of those promising indications, Merit agreed to make GAP its retrospective agent for any business procured by GAP after July, 1972. Further, Mr. Lebowitz of GAP ultimately persuaded Merit to reinsure those policies that had been written by GAP on behalf of LIC prior to July, 1972. As a result, LIC and Merit executed the Reinsurance and Assumption Agreement on October 20, 1972 which underlies the parties' dispute.

GAP's business had continued to deteriorate from August, 1971 to February, 1972. In particular, GAP improperly reduced its claim reserves and arbitrarily closed some of its claim files in order to create a fictitious impression of its outstanding liabilities. LIC's vice president determined that GAP had defrauded LIC, and the deteriorating relationship between LIC and GAP culminated in a lawsuit in a New Jersey state court. LIC obtained a judgment in June, 1972 for $1,489,000 against GAP, and several court orders provided LIC with direct access to

GAP's claim files. During the period from June, 1972 to October 20, 1972, LIC pursued its suit against GAP. Despite the ongoing litigation between the parties, LIC's attorney allegedly advised LIC to suspend any action in court against GAP that could place the pending negotiations between GAP and Merit in jeopardy. In addition, Merit alleges that LIC concealed the adverse facts concerning its relationship with GAP that could affect Merit's decision to complete the reinsurance transaction with GAP.

From 1969 to 1972, GAP failed to maintain a proper level of reserves for individual claim files. Because GAP failed to keep adequate reserves, LIC placed additional funds in a separate account, known as an IBNR account, in order to cover the outstanding claims arising from GAP's business. According to Merit, the total reserves actually held by GAP and LIC did not comport with the amount listed in their usual reserve funds. (Merit Brief, p. 18). Specifically, LIC had concealed from Merit the placement of over $1,000,000 in actual cash reserves into the IBNR account. (Merit Brief, p. 21). As a result, Merit executed the reinsurance agreement without knowledge of the $1,200,000 IBNR reserve fund or of other facts concerning LIC's adverse relationship with GAP.

LIC obtained a clear benefit by depositing over $1,000,000 into its "secret" IBNR reserve account. As previously stated, LIC had obtained a judgment against GAP in the amount of $1,489,000 in a New Jersey state court. Because Merit acquired the GAP policies without receipt of the total reserves from the carrier, LIC could apply the $1,000,000 in the IBNR account to the judgment which it had obtained against GAP. In that way, GAP would only need to pay $489,000 to LIC in order to satisfy its obligation. According to Merit, LIC knew that the insurance claims which it transferred to Merit would require more

reserves than it had concealed in the IBNR account. If GAP's deteriorating business had not been reinsured by Merit, LIC would have had to bear the losses incurred on the claims. According to the testimony of LIC's comptroller, Merit suffered a minimum loss of $1,000,000 as soon as the Reinsurance and Assumption Agreement was executed. (Merit Brief, p. 22).

Arbitration began in 1977 by order of this court on June 20, 1977 in the case of *Merit Insurance Company* v. *Anthony Colao,* 75 C 899. Judge Julius Hoffman issued his order in response to LIC's motion for arbitration of Counts VI, VII and VIII of Merit's Third Amended Complaint. Those Counts alleged that the defendants defrauded Merit in the purchase of the insurer's rights and obligations under the policies written by the agent GAP in New Jersey. Merit sought actual damages of $6,000,000 and exemplary damages of $9,000,000.

LIC had filed a "demand for arbitration" on December 27, 1976, more than six months before Judge Hoffman issued his order, to the American Arbitration Association. In that demand, LIC stated that "Merit Insurance Company claims in excess of $2,000,000 damages." (Exh. A, Merit Brief). Subsequent to Judge Hoffman's order, LIC filed a second "demand for arbitration" on June 27, 1977 in which it stated that "Merit Insurance Company claims in excess of $6,000,000 damages." (Exh. B, Merit Brief). In its trial brief before the arbitrators, Merit Insurance Company sought a total of $21,684,607 in compensatory damages, including lost profits, and a total of $7,228,202 in punitive damages. (Merit Trial Brief, p. 175).

In addition, Merit Insurance Company submitted several "tables on damages" as exhibits in the arbitration. Merit Exhibit 41 in Arbitration, which is dated July 12, 1978, shows total compensatory damages, including foregone

business, in the amount of $10,529,186. (Exh. 14, LIC Brief). Merit Exhibit 115 in Arbitration, which is dated June 16, 1980, shows total damages for the same categories in the amount of $13,669,687. (Exh. 15, LIC Brief).

The Reinsurance and Assumption Agreement of October 20, 1972 contains an arbitration clause stating that any controversy arising out of or relating to the contract shall be settled by arbitration in accordance with the Rules of the American Arbitration Association in "Camden County, New Jersey", and that judgment upon the award "may be entered in any New Jersey Court having jurisdiction thereof." (LIC Brief, Exh. 1, para. 17). Another clause states that "this agreement shall be construed and interpreted under the laws of the State of New Jersey." (LIC Brief, Exh. 1, para. 18). Because LIC requested the arbitration to proceed in Chicago, Illinois, there is no dispute for purposes of the parties' motions that Chicago was the proper site of the proceedings. Further, the parties agree that the arbitrators in Chicago were required to apply the law of New Jersey to the disputed issues. Finally, both this court and the federal district court in New Jersey ruled that the district court for the Northern District of Illinois is the appropriate forum for review of the Chicago arbitration proceedings.

After the arbitrators rendered their award in Merit's favor on December 1, 1980, Merit's counsel sent a letter on December 2, 1980 to the arbitrators which was designated as a "motion to clarify award." (LIC Brief, Exh. 3). The arbitrators had unanimously awarded "Merit Insurance Company the total sum of $10,675,000 for all damages claimed by Merit Insurance Company in this arbitration proceeding." (LIC Brief, Exh. 2). In its motion to clarify, Merit assumed that the foregoing phrase was not intended to include punitive damages, and it asked the arbitrators

to specify that the words "all damages" should be construed as "all compensatory damages." (LIC Brief, Exh. 3). The arbitrators issued the requested clarification on December 11, 1980, which stated in part that the sum was awarded to Merit "as compensatory damages only and does not include any sum for punitive damages"; they also wrote that "there is no intent by the Arbitrators to award any punitive damages in this proceeding." (LIC Brief, Exh. 7).

Respondent LIC asks this court to vacate or to modify the arbitration award for several reasons. LIC's principal argument is that the award of $10,675,000 when compared with Merit's actual out-of-pocket damages of between one and three million dollars, reflects the arbitrators' failure to follow the applicable law of New Jersey. Similarly, respondent contends that the award lacks "fundamental rationality", violates public policy, and includes punitive damages in violation of both New Jersey and federal law. Furthermore, respondent argues that "newly discovered evidence" suggests fraud in Merit's procurement of the award; that the arbitrators failed to allow a 50% set-off under the applicable contribution statute of New Jersey; and that the record demonstrates bias and prejudice on the part of the arbitrators. In support of those and other contentions, respondent cites the relevant subparagraphs of the Federal Arbitration Act, 9 U.S.C. §10(a)-(d).

This district court has original jurisdiction of motions to vacate and motions to confirm awards pursuant to the Federal Arbitration Act, 9 U.S.C. §§9 and 10, where interstate commerce is involved. *See e.g., Shearson Hayden Stone, Inc.* v. *Liang,* 493 F. Supp. 104, 106 (N.D. Ill. 1980), *aff'd* 653 F.2d 310 (7th Cir. 1981). The Reinsurance and Assumption Agreement between Merit Insurance Company and Leatherby Insurance Company is a contract that af-

fects interstate commerce. Moreover, the agreement's provision which states that the law of New Jersey must govern the arbitration does not bar review of the award in a federal district court. *See, eg., Hetherington & Berner, Inc.* v. *Melvin Pine & Co.*, 256 F.2d 103 (2d Cir. 1958). For purposes of this court's review of the arbitration award, the Federal Arbitration Act rather than state arbitration law applies.

This court's power to set aside the arbitration award is limited to the grounds set forth in 9 U.S.C. §10. *Shearson Hayden Stone, Inc.,* v. *Liang, supra,* 653 F.2d at 313; *Tamari* v. *Bache Halsey Stuart Inc.*, 619 F.2d 1196, 1198 n.2 (7th Cir. 1980).[1] The respondent LIC appears to rely on §§10(a), (b), (c) and (d) in support of its motion to vacate the award.

I.

The respondent LIC contends that the award should be vacated because the arbitrators failed to follow the applicable law of New Jersey in making their decision. The

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[1] 9 U.S.C. §10 provides:

In either of the following cases the United States Court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration.

(a) Where the award was procured by corruption, fraud or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any misbehavior by which the rights of any party may have been prejudiced.

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.

parties do not suggest, however, that their dispute was improperly assigned to arbitration under the terms of the arbitration clause in their written agreement.

It is well settled that an arbitration award will not be vacated on the ground that the arbitrators misinterpreted applicable law. *Nat. R.R. Pass. Corp.* v. *Chesapeake & O. Ry.*, 551 F.2d 136, 143 (7th Cir. 1977); *Sobel* v. *Hertz, Warner & Co.*, 469 F.2d 1211, 1214 (2nd Cir. 1972). As Judge Sprecher noted, some courts have construed the Supreme Court's decision in *Wilko* v. *Swan*, 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953), to permit vacation of an arbitration award which displays a "manifest disregard" of applicable law. *Nat. R.R. Pass. Corp.* v. *Chesapeake & O. Ry., supra*, 551 F.2d at 143. Even those courts which have adopted that view, however, have concluded that its application is "severely limited." *Id.* at 143.

This court's review of the arbitration award is somewhat troublesome in the instant case because the arbitrators gave no reasons for their award or decision. It is clear, however, that they are not required to do so. *See, e.g., Shearson Hayden Stone, Inc.* v. *Liang, supra*, 653 F.2d at 312. As Judge Feinberg observed, "the extent of an arbitrator's obligation to explain his award is necessarily related to the scope of judicial review", and that review becomes especially difficult insofar as it attempts to define "manifest disregard" of applicable law. *Sobel* v. *Hertz, Warner & Co., supra*, 469 F.2d at 1214. The Seventh Circuit Court of Appeals has shared the Second Circuit's reservations about whether the *Wilko* decision actually intended to add "manifest disregard" of the law to the statutory grounds for vacating an award in 9 U.S.C. §10. *See Nat. R.R. Pass. Corp* v. *Chesapeake & O. Ry., supra*, 551 F.2d at 143 n.9. As a practical matter, the courts can encounter great difficulty in distinguishing between an

arbitrator's "erroneous interpretation" of applicable law and his "manifest disregard" of it. *Id.* at 143 n.9. Moreover, "since arbitrators have no obligation to state the rationale underlying their award, there may be no basis whatsoever for a court to determine whether they have manifestly disregarded the law or simply misinterpreted it." *Id.* at 143 n.9.

The parties submitted detailed legal briefs on various issues under New Jersey law to the arbitrators. Counsel also presented a variety of expert witnesses as well as extensive oral summation in the course of the three-year proceeding; parties specifically addressed themselves to conflicting theories for the computation of damages which Merit had sustained. In addition, the parties' briefs in arbitration included arguments on whether lost profits or consequential damages may be properly recovered in an action for fraud under New Jersey law. The arbitrators "had the benefit of extremely detailed submission to arbitration," thorough memoranda of law, and oral summations of counsel which indicate a number of theories upon which the arbitrators may have decided. *See also Sobel* v. *Hertz, Warner, supra,* 469 F.2d at 1215. This court will not and need not impose its view on the validity of the theories underlying possible grounds for the award; it is sufficient if the award can in "any rational way" be derived from the applicable law of New Jersey. *See, e.g., Ludwig Honold Mfg. Co.* v. *Fletcher,* 405 F.2d 1123, 1128 (3rd Cir. 1969).

As the petitioner's briefs both before the arbitrators and this court have correctly stated, there is ample support in New Jersey law for the inclusion of lost profits in damages incurred because of fraud. The courts of New Jersey have consistently held that "loss of profits, where based on sound fact and not on mere opinion evidence, is recognized

as a proper measure of damages if capable of being estimated with a reasonable degree of certainty." *Henry Clay* v. *Jersey City*, 74 N.J. Super. 490, ..., 181 A.2d 545, 549 (1962) [cites omitted]. Further, the Supreme Court of New Jersey has recognized that "the victims of fraud are entitled to compensation for every wrong which was the natural and proximate result of the fraud." *Zeliff* v. *Sabatino*, 15 N.J. 70, ..., 104 A.2d 54, 56 (1954). Those and other cases were cited in the arbitration briefs and it is therefore clear that the arbitrators did not simply ignore the applicable law. The arbitrators' possible reliance upon such cases or theories does not provide a basis for vacating the award.

Respondent's argument that the arbitrators awarded an excessive amount of damages in violation of New Jersey law boils down to an assertion that they reached the wrong result from conflicting evidence and testimony. This court may not vacate the award on that ground. *See, e.g., Shearson Hayden Stone* v. *Liang, supra*, 653 F.2d at 312. The arbitrators were free to compute the amount of damages from the conflicting evidence before them. Similarly, this court cannot reconsider the evidence in order to determine whether any independent investigation that Merit may have undertaken was sufficient to negate its reliance on LIC's false representations. It is clear that the arbitrators, having considered the evidence, concluded that Merit was entitled to rely upon LIC's representations.

Respondent also contends that the award of $10,675,000 should be vacated under 9 U.S.C. §10(d) because it lacks fundamental rationality. Specifically, respondent asserts that the amount of the award is irrational in view of respondent's failure to report $1,000,000 in claim reserves in the reinsurance transaction. The Seventh Circuit has not decided whether an arbitration award may be vacated

under the Federal Arbitration Act on the ground of "irrationality." *Shearson Hayden Stone* v. *Liang, supra,* 653 F.2d at 312; *Nat. R.R. Pass. Corp.* v. *Chesapeake & O. Ry., supra,* 551 F.2d at 142 n.5. A court also faces great difficulties in attempting to assess the rationality of an award where the arbitrators have given no reasons for the award.

Judge Flaum used the same analysis in determining whether an arbitration award was either "fundamentally irrational" or in "manifest disregard" of the law under 9 U.S.C. §10(d). *Shearson Hayden Stone* v. *Liang, supra,* 493 F. Supp. at 108. In the instant case, there was ample evidence submitted to the arbitrators, both in the form of briefs and expert testimony, that could support the amount of the award. Indeed, a review of that evidence and the applicable law compels the conclusion that the arbitrators were following the law in their award and did not manifestly disregard it or mandate a fundamentally irrational result. There is no basis to conclude that section 10(d) of the Act was violated.

II.

Respondent LIC argues that the large amount of the arbitration award indicates that it is inherently punitive because it vastly exceeded Merit's out-of-pocket losses. In addition, respondent contends that the arbitrators' clarification of their award was ineffective.

In response to Merit's motion, the arbitrators issued a clarification of their award on December 11, 1980 which stated that the sum of $10,675,000 was awarded to Merit "as compensatory damages only and does not include any sum for punitive damages." (LIC Brief, Exh. 7). Further, the clarification stated that "there is no intent by the Adbitrators to award any punitive damages in this proceeding." (Exh. 7). In the course of the arbitration proceed-

ings, Merit submitted various exhibits and expert testimony that could support an award in excess of $10,675,000 for compensatory damages, including lost profits. (See, e.g., Merit Trial Brief, p. 175; Exh. 15, LIC Brief; Plotkin testimony, etc.).

Arbitrators may use their discretion in the computation of damages, and a court may not lightly disturb that arbitrators' exercise of that discretion where the evidence and theories presented in arbitration could have sustained the sum of the award. Judicial review of the arbitrators' method of computation is especially restricted where no reasons have been given for the award. The respondent's repeated assertion that "punitive damages" were awarded will not suffice to vacate an arbitration award where discretion is used in the computation of damages; only where the damages are genuinely intended to be punitive should the courts vacate the award. *See, e.g., John T. Brady & Co.* v. *Form-Eze Systems, Inc.*, 623 F.2d 261 (2nd Cir. 1980), *cert. denied* 101 S. Ct. 786 (1980) citing *Board of Education* v. *Niagara-Wheatfield Teachers Ass'n*, 46 N.Y.2d 553, 558, 389 N.E.2d 104, 106 (1979).

In this case, the arbitrators did not label the award of $10,675,000 as "punitive" and there is nothing to indicate a genuine intention that the award punish the respondent. *Id.* at 264. On the contrary, the clarification of the award made it absolutely clear that the arbitrators did not intend to include punitive damages in any part of the award. Courts have generally accorded the narrowest of readings to the Act's authorization to vacate awards where the arbitrators have exceeded their powers under 9 U.S.C. §10(d). *Id.* at 264. In this case the arbitrators did not characterize the award as punitive and there is no reason for this court to assume that it was. Moreover, respondent has failed to convince this court that the arbitrators' clarification was either invalid or improper.

Respondent LIC also contends that the arbitration award should be vacated because it violates public policy. Although contravention of public policy is not one of the specific grounds for vacation set forth in section 10 of the Federal Arbitration Act, an award may be set aside if it compels the violation of law or is contrary to a well accepted and deep rooted public policy. *Diapulse Corp. of America* v. *Carba, Ltd.*, 626 F.2d 1108, 1110 (2nd Cir. 1980). In support of its argument, respondent asserts that the arbitrators failed to decide the dispute in accordance with New Jersey law and that the award was both punitive and speculative.

There is certainly nothing in the award that compels the violation of law. The arbitrators may have determined that lost profits may be properly recovered for fraud under New Jersey law, and they explicitly stated that punitive damages constituted no part of the awarded sum. As a result, the award did not infringe any deep rooted public policy against punitive damages. Moreover, compensatory damages do not become punitive whenever they are somewhat speculative. *See, e.g., John T. Brady & Co.* v. *Form-Eze Systems, Inc., supra,* 623 F.2d at 264. There is no public policy prohibiting an arbitration tribunal from awarding a defrauded party compensatory damages, including lost profits, that are the proximate result of the fraudulent transaction.

III.

Respondent argues that the award should be vacated for fraud under §10(a) of the Act because Merit's annual financial statement, which was released on March 1, 1981, indicates that the arbitrators relied upon erroneous estimates for Merit's reserves. The reserve estimates for 1977, 1978, and for the first half of 1979 suggested that Merit's insurance business was extremely profitable,

whereas the subsequent statement of March, 1981 suggests that Merit was substantially underreserved. LIC attempts to rely on the "newly discovered evidence" that became available on March 1, 1981 to vacate the award made on December 1, 1980.

The Federal Arbitration Act does not allow vacation of an award for new evidence. *Shearson Hayden Stone, Inc.* v. *Liang, supra,* 653 F.2d at 313. Moreover, no case expressly holds that new evidence or nondisclosure of evidence constitutes "fraud" under section 10(a). *Id.* at 313. This court has also recognized that newly discovered evidence, even if it could not have been discovered prior to the arbitration proceeding, may not be used to directly contradict the evidence presented during the arbitration proceeding. *Shearson Hayden Stone, Inc.* v. *Liang, supra,* 493 F. Supp. at 109 citing *Washington-Baltimore Newspaper Guild Local 35* v. *Washington Post Co.,* 442 F.2d 1234, 1238-39 (D.C. Cir. 1971).

As Merit has stated in its brief, all of its financial reports that existed as of December 1, 1980 were made available to the arbitrators. The arbitrators had the discretion to use and to assess the available reports as they saw fit. The gist of respondent's argument is that the arbitration should be reopened whenever new financial reports are issued on Merit Insurance Company in order to enable more accurate projections of the company's profitability. If respondent were correct, the arbitration in this case would never end. The arbitrators were free to consider all of the financial data that Merit had at its disposal during the course of the proceedings; they could do no more. In effect, respondent's argument implies that any arbitration award, which is based in part on reasonable estimates of lost profits, should be vacated whenever the subsequent financial statements of the ag-

grieved party do not comport with those estimates. Such a result would wreak havoc upon the arbitration process, and this court will not vacate the award on those grounds.

IV.

Respondent also argues that the arbitrators ignored the applicable law of New Jersey because they refused to allow a pro rata setoff of fifty percent on the award. A New Jersey statute, N.J.S.A. Ch. 2A-53A-1 *et seq.*, provides for a right of contribution among joint tortfeasors. Because Merit had settled its claim with GAP's president, Leonard Lebowitz, respondent LIC contends that its own liability as the remaining tortfeasor should be reduced by half. Respondent claims that the arbitrators imperfectly executed their powers under §10(d) by failing to apply the setoff under the New Jersey contribution statute. Respondent concedes that it asserted its right to the setoff in the arbitration proceedings by extensive briefs and argument. (LIC Brief, p. 49).

Respondent's claim here reduces to the proposition that the arbitrators either ignored or misapplied New Jersey's contribution statute. There is no basis upon which this court may conclude that the arbitrators "manifestly disregarded" the applicable law. First, the arbitrators may have concluded upon consideration of the parties' briefs and evidence that Mr. Lebowitz was an "agent" of LIC. If that were so, LIC and Lebowitz as principal and agent could not be treated as joint tortfeasors under the New Jersey statute. Second, even if the arbitrators regarded Lebowitz as a joint tortfeasor, there is nothing to indicate that the arbitrators failed to apply the contribution statute. Respondent assumes that Lebowitz was equally liable for the transaction, and that LIC is therefore entitled to a fifty percent setoff. The arbitrators, however, may have concluded that Lebowitz was responsible only

to the extent of one, two, or ten percent of the total liability. If so, it is possible that the award of $10,675,000 reflects the arbitrators application of a setoff in view of Merit's settlement with Lebowitz. The parties briefed these issues in full and supported their positions with oral argument. Certainly, the arbitrators could have made their decision on any one of those or other theories. *See, e.g., Sobel* v. *Hertz, Warner & Co., supra*, 469 F.2d at 1215.

This court must necessarily speculate whether the arbitrators "manifestly disregarded" the New Jersey contribution statute or whether in fact they found it applicable. As stated above, the extent of an arbitrator's obligation to explain his award is necessarily related to the scope of judicial review, and such review is severely limited where no reasons are given for the award. *Id.* at 1214. Furthermore, this court cannot properly reverse the award even if it was based upon a "clearly erroneous interpretation" of the New Jersey contribution statute. *See, e.g., I/S Stavborg* v. *National Metal Converters, Inc.*, 500 F.2d 424, 432 (2d Cir. 1974). No such showing is made here. Respondent as the challenging party has the burden to establish substantially more than an erroneous conclusion of law or fact. *Local Union No. 251* v. *Narragansett Improvement Co.*, 503 F.2d 309, 312 (1st Cir. 1974). Respondent has failed to sustain that burden.

V.

Respondent argues that the award should be vacated under §§10(b) and (c) of the Federal Arbitration Act because the arbitrators exhibited bias and prejudice towards LIC. At the outset, LIC claims that the arbitrators' decision to cut off any evidence of lost profits on June 30, 1979 prevented respondent from submitting subsequent data that would provide more accurate evidence of Merit's

profitability. The argument, as respondent concedes, is similar to that of the "newly discovered evidence." (LIC Brief, pp. 54-55).

Respondent suggests that an accurate assessment of Merit's profitability for the years 1977 to 1979 could only be made in retrospect from financial statements that would become available in 1985. (See LIC Brief, pp. 53-55). In other words, an exact appraisal of Merit's lost profits for any stated period could only be made five years later. In effect, respondent suggests that the arbitrators were biased because they did not wait until 1985 to determine Merit's consequential damages with precision. This court does not agree.

Arbitration proceedings are not governed by the rules of evidence. *Shearson Hayden Stone, Inc.* v. *Liang,* 653 F.2d at 313. The arbitrators are vested with broad discretion and control over the procedures and standards used with respect to the evidence. It was certainly logical for the arbitrators to establish a cut off date for proof of Merit's projected profitability; the alternative would have been to suspend the proceedings for several years in order to assess retrospectively Merit's actual profits. That approach is neither desirable nor practical. In addition, the cut off date of June 30, 1979 was sensible because it was the current date of the trial. (LIC Brief, p. 53). Certainly, it was reasonable for the arbitrators to consider all the financial statements that were available as of the time when the computation was to be made. Under respondent's suggestion, the arbitration would have been prolonged for several additional years in order to establish the company's future profitability with certainty, and any arbitration award could then be vacated because of any change in the company's financial status after the award has been made.

The respondent asserts that the arbitrators were prejudiced because they refused to hear evidence from Merit's independent auditors over the respondent's objection. Respondent concedes, however, that the auditors' refusal to testify in this matter on the ground of privilege was upheld by Judge Bua in *Western Employers Insurance Company* v. *Merit Insurance Company and Peat Marwick Mitchell & Co.*, 492 F. Supp. 53 (N.D. Ill. 1980). Respondent argues that the arbitrators were biased because they refused to compel the auditors to testify in spite of Judge Bua's ruling. (LIC Brief, pp. 56-57). That argument is misplaced. The arbitrators properly allowed the invocation of the auditors' privilege to be reviewed by this court, and they certainly exhibited no bias towards LIC by following the court's decision.

Respondent argues that the arbitrators manifested their bias by awarding Merit with $10,675,000, by issuing the clarification of their award in response to Merit's motion, and by one comment that an arbitrator made in May of 1979. This court has already noted that the amount of the award was not in manifest disregard of the applicable law, and that the sum of the award could have been supported by any one of several theories. Further, the arbitrators did nothing improper or irregular in issuing a clarification of their award in response to Merit's request. Finally, the entire context in which Mr. Bolton made his comment on page 7851 of the arbitration transcript indicates only that the arbitrator was expressing his opinion on the possible relevance of certain evidence that LIC had read into the record. Arbitrators are free to comment on the possible relevance of any evidence that comes before them.

In setting aside an award for bias, the Seventh Circuit Court of Appeals has stated the "guiding principle" is that "the interest or bias of an arbitrator must be direct,

definite, and capable of demonstration rather than remote, uncertain, or speculative." *Tamari* v. *Bache Halsey Stuart Inc., supra,* 619 F.2d at 1200 citing *United States Wrestling Federation* v. *Wrestling Division of the AAU, Inc.,* 605 F.2d 313, 318 (7th Cir. 1979). That principle applies whether actual bias or merely an appearance of bias is charged. *Id.* at 1200. The arguments of respondent suggests at most that the possibility of bias was highly speculative, and there is no direct or definite indication in the record of such bias. At this stage of the proceedings, respondent's assertions that bias and prejudice characterized the arbitrators' conduct and award have a distinctly hollow ring.

VI.

Petitioner Merit asks this court to award interest in the event that judgment is entered on the arbitration award. As both parties correctly observe, state law governs the award of interest in diversity cases. *Michael-Regan Co., Inc.,* v. *Lindell,* 527 F.2d 653, 659 (9th Cir. 1975); *Lundgren* v. *Freeman,* 307 F.2d 104 (9th Cir. 1962). The parties dispute, however, whether the interest statute of Illinois, Ill. Rev. Stat., Ch. 74, §53, or of New Jersey, N.J.S.A.R. 4:42-11(a), should apply.

In cases such as this where the parties, arbitration, and transaction touch a number of states, the question may arise as to which state's law applies. *See, eg., In Re Air Crash Disaster Near Chicago, Ill., Etc.,* 480 F. Supp. 1280, 1282 (N.D. Ill. 1979) citing *Klaxon Co.* v. *Stentor Electric Mfg. Co., Inc.,* 313 U.S. 487, 496 (1941). This court finds, however, that it need not decide which state's law applies with respect to the issue of interest on the arbitration award. *Id.* at 1283. Only in cases where a conflict exists between the laws of the various states would it be necessary to decide the applicable state law. *Id.* at 1283. Where all

of the states whose law might apply have substantially the same law, no conflict is presented. *Id.* at 1283. Because interest is available under the statutes of both Illinois and New Jersey, no true conflict of law therefore exists.

The applicable portion of the New Jersey statute provides:

> (a) RATE. Judgments, AWARDS and orders for the payment of money and taxed costs shall bear simple interest on the amount of the award at 8% per annum from the date of entry, except as otherwise ordered by the court. N.J.S.A.R. 4:42-11(a) (emphasis supplied)

A New Jersey court has construed the statute's applicability to an arbitration award by holding that interest should be computed from the date of the arbitration award. *Ukranian National Etc.* v. *J. L. Muscarelle, Inc.*, 151 N.J. Super. 386, 376 A.2d 1299 (1977). As a result, interest would be computed on a per annum basis from the date of the arbitration award on December 1, 1980.

Similarly, Illinois' general interest statute provides in part:

> . . . [W]hen judgment is entered upon any AWARD, report or verdict, interest shall be computed at the above rate from the time when made or rendered to the time of rendering judgment upon the same, and made a part of the judgment. Ill. Rev. Stat., Ch. 74, §53 (emphasis supplied)

Illinois courts have held that interest should be computed from the date of the arbitration award and included into the judgment. *See, e.g., Wrobel* v. *Argiris*, 73 Ill. App. 3d 648, 392 N.E.2d 681 (1979).

Interest on the arbitration award is therefore available under both the law of New Jersey and Illinois, and it should be computed on a per annum basis as of December

1, 1980, when the award was made. Because the parties agree that the law of New Jersey governed the arbitration, this court holds that the precise interest rate of 8% per annum applies to the award under the New Jersey statute.

VII.

For the foregoing reasons, the petition of Merit Insurance Company to confirm the arbitration award of $10,675,000, which was made on December 1, 1980, is granted. The motion of respondent Leatherby Insurance Company to vacate, to modify, or to correct the award is denied. The judgment confirming the award incorporates interest on the award as computed per annum from December 1, 1980 at the rate of 8%.

/s/ *Charles P. Kocoras*
Charles P. Kocoras
United States District Judge

DATED: November 19, 1981

APPENDIX C

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604
July 12, 1983

Before
Hon. WALTER J. CUMMINGS, Chief Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. THOMAS E. FAIRCHILD, Senior Circuit Judge
No. 82-2885

MERIT INSURANCE COMPANY, Plaintiff-Appellant,

vs.

LEATHERBY INSURANCE COMPANY a/k/a
WESTERN EMPLOYERS INSURANCE COMPANY,
Defendant-Appellee.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.
No. 80 C 6758
Judge Charles P. Kocoras

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and the case is REMANDED, with directions, in accordance with the opinion of this Court filed this date.

APPENDIX D

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

September 12, 1983

Before
Hon. WALTER J. CUMMINGS, Chief Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. THOMAS E. FAIRCHILD, Senior Circuit Judge

No. 82-2885

MERIT INSURANCE COMPANY, Plaintiff-Appellant,

vs.

LEATHERBY INSURANCE COMPANY a/k/a
WESTERN EMPLOYERS INSURANCE COMPANY,
Defendant-Appellee.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.
No. 80 C 6758
Charles P. Kocoras, Judge

ORDER

On July 26, 1983, respondent-appellee Leatherby Insurance Company filed a petition for rehearing with suggestion for rehearing *en banc*. All of the judges of the original panel have voted to deny the petition, and none of the active members of the court has requested a vote on the suggestion for rehearing *en banc*. The petition is therefore DENIED.

APPENDIX E

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, D.C. 20543

December 5, 1983

Mr. Philip W. Tone
Jenner & Block
One IBM Plaza
Chicago, IL 60611

Re: Leatherby Insurance Company, etc.,
v. Merit Insurance Company
No. 83-653

Dear Mr. Tone:

The Court today entered the following order in the above entitled case:

The petition for a writ of certiorari is denied.

Very truly yours,

/s/ *Alexander L. Stevas*
Alexander L. Stevas, Clerk